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No. 93-952

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In The

Supreme Court of the United States

October Term, 1993

ITT CONSUMER FINANCIAL CORP., AETNA FINANCE CO., ITT LYNDON PROPERTY INS. CO., ITT LYNDON LIFE INS. CO., JOHN M. HIGGINS AND ASAD ZAFARI,

Petitioners,

v.

ABBE KANAREK PATTERSON, et al.,

Respondents.

On Petition For A Writ Of Certiorari To The California Court Of Appeal First Appellate District

OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether the California Court of Appeal erred in applying general principles of contract law to determine the underlying validity of an arbitration provision alleged to be unconscionable and unenforceable because it effectively denied consumers a fair opportunity to present or defend claims.

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Respondents Johnny Davis, James P. Jacobs, Thomas Pierce, Zenia M. Velasco, Dona Wessels, Jorge De La O, and John Lang, on behalf of themselves and a proposed class of similarly-situated California consumers, (hereinafter referred to collectively as "Respondents"), respectfully request that this Court deny the Petition for Writ of Certiorari pending in this matter.

INTRODUCTION

This is a factually-unique case in which the California Court of Appeal was required to determine, as a matter of basic contract law, the underlying validity and enforceability of an arbitration provision. Based on evidence in the record and applying general principles of state contract law, the Court of Appeal held that the arbitration provision, which was contained in a standard form contract for small consumer loans, and which required California consumers to submit to arbitration in a forum located in Minneapolis, Minnesota, was unconscionable and therefore unenforceable.

The decision below raises no issue that is not conclusively resolved by the provisions of the Federal Arbitration Act itself, 9 U.S.C. §2, ("the FAA"), and by previous well-considered decisions of this Court. Furthermore, as Respondents will demonstrate in the sections following, there is no conflict between the decision of the Court of Appeal below and the decisions of the Ninth Circuit interpreting and applying the FAA. Rather, Petitioners have attempted to create the appearance of conflict, where none in fact exists, by deliberately ignoring an important distinction between two issues that arise in cases governed by the FAA. The first issue, which is the issue that arose in this case, is the question of the underlying validity and enforceability of the arbitration agreement. This Court has previously instructed that this determination is to be made according to general principles of state contract law. *See Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987); 9 U.S.C. §2. The second issue that frequently arises, but which was not present in any manner in this case, is the scope of the arbitrable issues under

an admittedly valid and enforceable arbitration agreement. This Court has ruled that such a determination is to be made as a matter of federal law. *See Moses H. Cone Memorial Hosp. v. Mercury Construction Co.*, 460 U.S. 1, 24-25 (1983). Once this important distinction is made between the *validity* of an arbitration provision under general principles of contract law, and the *arbitrability* of a particular dispute as a matter of federal law, it is quite clear that there is no conflict among the lower courts, and accordingly, there is no basis for this Court's review.

Moreover, as will be demonstrated herein, regardless of whether state or federal law applies, the result would be the same in this case. At bottom, what is before this Court is an arbitration provision that two courts, exercising *de novo* review of substantial evidence in the record, and applying long-established and generally-applicable principles of contract law, have found to be unconscionable and unenforceable. The Federal Arbitration Act itself, and the numerous decisions of this Court interpreting that statute, establish that an arbitration provision is rendered unenforceable or revocable "upon such grounds as exist in law or in equity for the revocation of any contract." 9 U.S.C. §2.[1] That is precisely the principle that

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[1] It is important to note that the record below is devoid of any evidence or finding, as a matter of fact or law, that the small consumer loan transactions at issue actually involved interstate commerce such that the Federal Arbitration Act applied. Petitioners argued in the courts below that the provision was governed by the FAA, and there was much briefing by both parties as to the applicability and requirements of federal law. Respondents denied that the FAA applied, however, because the transactions occurred entirely within California between California

was applied by the trial court and by the California Court of Appeal in this case. The state law standard for determining unconscionability applied by the court below is generally applicable to any contract provision, and is derived directly from federal common law. The decision below applying that standard to the disputed arbitration provision was limited to the unique facts of this case and was well supported by evidence in the record. The determination would not have been any different had the court applied federal common law.

Petitioners have also argued that the decision below indicates that California courts are hostile to arbitration agreements. This assertion is similarly contrary to established law. California courts, in particular the California Supreme Court, have repeatedly emphasized the state's strong policy favoring arbitration and the courts' willingness to enforce valid arbitration agreements. The arbitration agreement in this case was denied enforcement by the Court of Appeal solely because the unique facts and circumstances of this case clearly rendered the provision unconscionable as a matter of basic contract law. This very limited decision neither resulted from, nor evidenced any, hostility toward arbitration agreements. Nor does the decision conflict in any way with the provisions of the FAA, the decisions of this Court, or the decisions of the Ninth Circuit. Indeed, because the sole issue in this

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consumers and businesses licensed to make loans by the State of California. Respondents also argued that, regardless of whether the FAA applied, the preliminary determination as to whether a valid and enforceable agreement existed was to be made according to state law. *Perry v. Thomas, supra,* 482 U.S. 483, 492, n.9.

case is the basic validity of a contract provision, the case presents no federal question whatsoever.

STATEMENT OF THE CASE

This is a consumer class action in which Respondents, all lower and middle income consumers residing in California, allege that Petitioners engaged in unlawful, unfair, and fraudulent business practices in the soliciting, making, and collecting of small consumer loans, and in the collateral sale of credit insurance policies.[2] Respondents allege, *inter alia*, that Petitioners falsely advertised consumer loan products; deceived borrowers about the terms of loan transactions and loan documents; forced consumers to purchase various insurance policies as part of the loan transaction; deceived consumers about additional charges imposed for insurance; systematically churned borrowers' accounts; and engaged in a pattern of

[2] The original Complaint in this action was filed on September 26, 1991 on behalf of ten named plaintiffs and a proposed consumer class. A companion case was filed on behalf of Respondent John Lang. Only four of the original ten named plaintiffs in the *Patterson* action, and John Lang, signed loan documents containing the disputed arbitration provision. Two additional plaintiffs were added by a subsequent amended complaint. Thus, although there are twelve named plaintiffs in the action, only six are Respondents to this Petition. The remaining six plaintiffs, and all other members of the proposed class whose loan documents did not contain the arbitration provision are unaffected by the arbitration dispute. Thus, the parties have litigated substantive law and motion matters and proceeded with discovery as to the "non-arbitration" plaintiffs and other class members.

unlawful and abusive debt collection practices. Respondents allege causes of action under several California consumer protection statutes and common law theories of recovery, and seek class certification, injunctive and declaratory relief, restitution, compensatory and punitive damages, and attorneys' fees and costs.

After the action was initially removed to federal court, and subsequently remanded to the state court, Petitioners moved to compel arbitration against Respondents based on a standardized arbitration clause that was contained in one of the numerous standard form documents they were required to sign at the time they took out their loans. This provision purported to obligate Respondents to resolve any claims against ITT Financial Services "by binding arbitration by the National Arbitration Forum, Minneapolis, Minnesota." The provision also asserted that the transaction was in interstate commerce and subject to the Federal Arbitration Act, 9 U.S.C. §§1-14. Respondents opposed the motion to compel arbitration on several grounds, including, *inter alia*, that the provision was unconscionable in its setting, purpose and effect, and therefore unenforceable under general principles of contract law; and that Respondents did not know that the documents they were required to sign contained an arbitration provision, and did not knowingly consent to arbitration.

To support the claim of unconscionability, Respondents presented substantial evidence regarding the circumstances under which the arbitration agreements were signed, and the purpose and effect of the arbitration

provision.[3] As an initial matter, the evidence established that Respondents are all relatively unsophisticated consumer borrowers. The evidence also established that, at the time they took out their loans, these consumers were instructed to sign several documents, but were not aware and were not informed by Petitioners that one of the documents contained an arbitration provision. The evidence further established that the disputed provision was merely one paragraph on a form that, although titled "Agreement for Dispute Resolution," for most unsophisticated consumers, appeared to contain only customer service information, not contractual provisions.

The evidence also established that, by designating a distant, expensive, and inaccessible forum – the National Arbitration Forum, located in Minneapolis, Minnesota (the "NAF") – the arbitration provision was designed to, and effectively did, deny California consumers any real opportunity to present or to defend claims against Petitioners. Specifically, the evidence showed that after Petitioners filed claims against California consumers in the Minnesota forum, the NAF sent notification of the claim and invited the consumer to send in a written response to Minnesota. If a California consumer failed to send in a written response in the time allowed, a default award was entered through a purely administrative process. No arbitration occurred. If a consumer did send in a written response, jurisdiction was deemed conferred on the NAF in Minnesota, and an arbitrator sitting in Minnesota

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[3] This evidence was presented to the trial court in the form of sworn declarations and exhibits attached thereto. The full record was transmitted to the Court of Appeal.

would render an award based solely on the documents submitted. Under the NAF rules, no participatory hearing was ever held unless the consumer specifically requested such a hearing and submitted the minimum three-hour hearing fee of $750.00.

Although Petitioners asserted that California residents could request a hearing in their home district, and that indigent persons could obtain a waiver of the hearing fee, the evidence established that the NAF rules on these issues were unintelligible, ambiguous and misleading.[4] (Petition Appendix, at 8a.) Despite their attempts to justify the NAF rules regarding hearing fees, fee waivers, and hearing location, Petitioners failed to present any evidence that any California consumer had ever obtained a participatory hearing through the NAF, either in California or elsewhere. Rather, the evidence in the record, including declarations submitted by NAF personnel and the trial court's own records, established that, as a practical matter, Petitioners used the arbitration provision routinely to obtain default arbitration awards against California consumers through a purely administrative process at the NAF in Minneapolis, and then to convert those awards into judgments in California courts. Based on this evidence, and applying well-established principles of contract law, the trial court found the arbitration provision to be unconscionable and unenforceable, and

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[4] In the lower courts, Petitioners repeatedly characterized the NAF as "headquartered" in Minneapolis. No evidence was ever introduced, however, to indicate that the NAF had any office or facility other than the one located in Minneapolis. Nor was there any evidence presented of any NAF facility in California or of any NAF proceeding ever occurring in California.

on that basis denied Petitioner's motion to compel arbitration.[5] (*See* Petition Appendix, 14a-19a.)

On appeal, applying *de novo* review, the California Court of Appeal independently examined the evidence in the record, applied long-standing and well-established standards of unconscionability under California law that are applicable to contracts in general, and unanimously concluded that the arbitration provision was unconscionable as a matter of law and therefore unenforceable. (*See* Petition Appendix, at 3a-13a.) The court made this determination based on findings both as to the circumstances under which the arbitration provision was presented for signature to consumer borrowers, and the effect of the provision in discouraging and/or denying consumers any meaningful opportunity to present or to defend claims. Contrary to misrepresentations made by Petitioners, the court did not determine that the provision was unconscionable merely because it was a contract of adhesion. In fact, the Court specifically noted that "a contract of adhesion is still fully enforceable." (Appendix, at 5a.) Rather, the findings that the standardized contract was one of adhesion between parties of great disparity of bargaining power, that there had been no negotiation of terms, and that Respondents were unaware of the arbitration provision, were merely factors in the Court of Appeal's overall determination that the provision was procedurally and substantively unconscionable.

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[5] The trial court made no findings as to whether Respondents had consented to arbitration, or whether their signature on the arbitration agreements had been procured by fraud.

The decision of the Court of Appeal was based on the standard for determining unconscionability set forth in *A & M Produce Co. v. FMC Corp.*, 135 Cal.App.3d 473, 186 Cal.Rptr. 114 (Cal.App.4 Dist. 1982). This standard has long been held applicable to contracts generally, and was applied by the Court of Appeal to the arbitration provision just as it would have been applied to any other contract term. Furthermore, the standard for determining unconscionability set forth in *A & M Produce*, and applied by the Court of Appeal below, is derived directly from federal common law. (*See* discussion at II., *infra.*)

After their petition for rehearing was denied by the Court of Appeal, Petitioners petitioned the California Supreme Court for review. Although the California Supreme Court has made clear in recent years its unrelenting commitment to the enforcement of valid arbitration agreements, and its own strong endorsement of judicial policy favoring arbitration, that Court unanimously denied review in this case.

REASONS FOR DENYING THE WRIT

I. THE DECISION OF THE COURT OF APPEAL IS NOT IN CONFLICT WITH EITHER THE DECISIONS OF THIS COURT OR THE DECISIONS OF THE NINTH CIRCUIT AS TO THE APPLICABLE LAW IN DETERMINING THE VALIDITY OF ARBITRATION AGREEMENTS GOVERNED BY THE FEDERAL ARBITRATION ACT.

The decision of the California Court of Appeal is fully consistent with the provisions of the FAA, applicable

decisions of this Court, and the decisions of the Ninth Circuit Court of Appeals. As is explained below, the conflict Petitioners have attempted to create simply does not exist.

Section 2 of the Federal Arbitration Act specifically provides that an arbitration agreement is "valid, irrevocable, and enforceable, *save upon grounds as exist at law or equity for the revocation of any contract.*" 9 U.S.C. §2 (emphasis added). Thus, arbitration agreements are subject to the same general principles of contract law that would render any contractual provision invalid, unenforceable or revocable. *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 625 (1985); *Southland Corp. v. Keating*, 465 U.S. 1, 16 n.11 (1984). In the past, this Court has cautioned that privately-negotiated agreements to arbitrate are "as enforceable as other contracts, *but not more so.*" *Volt Info. Sciences v. Bd. of Trustees*, 489 U.S. 468, 478 (1989), *quoting Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 n.12 (1967) (emphasis added). There is no support in either the Federal Arbitration Act, or in the decisions of this Court, for Petitioners' contention that, as a matter of federal law, arbitration provisions are to be accorded special status and excused fundamental defects that would annul any other contract provision.

This Court has also specifically addressed and answered the issue Petitioners claim is raised by this Petition – whether it is state or federal law that is to be applied in determining if an arbitration provision is revocable "upon grounds as exist at law or equity for the revocation of any contract." 9 U.S.C. §2. This Court has consistently and repeatedly instructed that the preliminary determination of the validity of an arbitration agreement is to be made according to general principles of

state contract law. In *Perry v. Thomas, supra,* 482 U.S., at 492 n.9, this Court stated as follows:

> We also decline to address Thomas' claim that the arbitration agreement in this case constitutes an unconscionable, unenforceable contract of adhesion. This issue was not decided below, see nn. 4 and 6, *supra,* and may likewise be considered on remand.
>
> We note, however, the choice-of-law issue that arises when defenses such as Thomas' so-called 'standing' and unconscionability arguments are asserted. In instances such as these, the text of §2 provides the touchstone for choosing between state-law principles and the principles of federal common law envisioned by the passage of that statute: An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law,* see *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), 'save upon grounds as exist at law or in equity for the revocation of *any* contract.' 9 U.S.C. §2 (emphasis added). Thus state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.

(Emphasis in original.)

Petitioners have asserted that this Court's very clear instruction in *Perry* was merely "dictum," and have falsely suggested that it conflicted with earlier decisions of this Court and other Courts of Appeal. (Petition, at 16.) In fact, the holding in *Perry* was fully consistent with earlier decisions of this Court. *See e.g., Mitsubishi Motors*

Corp. v. Soler Chrysler-Plymouth, supra, 473 U.S., at 627 ("Of course, courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' 9 U.S.C. §2."); *Southland Corp. v. Keating, supra,* 465 U.S., at 16 n.11. ("We agree, of course, that a party may assert general contract defenses such as fraud to avoid the enforcement of an arbitration agreement.). Furthermore, the *Perry* rule was subsequently referenced and reaffirmed in this Court's decision in *Volt Info. Sciences v. Board of Trustees, supra,* 489 U.S., at 475-76, a case conspicuously absent from the Petition, in which the Court stated:

> These cases of course establish that, *in applying general state-law principles of contract interpretation of an arbitration agreement within the scope of the Act, see Perry v. Thomas, 482 U.S. 483, 493, n.9,* . . . due regard must be given to the federal policy favoring arbitration, and ambiguities as to the scope of the arbitration clause itself resolved in favor of arbitration.

(Emphasis added.) *See also Gilmer v. Interstate/Johnson Lane Corp.,* 500 U.S. 20, 111 S.Ct. 1647, 1656 (1991) (reaffirming the holding in *Mitsubishi Motors Corp.* that courts should remain attuned to well-supported claims of unequal bargaining power in determining the enforceability of an arbitration provision). Thus, this Court has made clear in *Perry v. Thomas,* and in decisions prior and subsequent to *Perry,* that the initial determination of the underlying validity and enforceability of an arbitration agreement is to be made according to general principles of state contract law.

The cases cited by Petitioners in their attempt to create the appearance of conflict are easily distinguishable. In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp., supra,* 460 U.S. 1, and in the Ninth Circuit cases cited in the Petition, the issue addressed was whether a particular dispute was within the *scope* of the parties' admittedly valid arbitration agreement, (i.e., the "arbitrability" of the dispute). It is well-established that this is a separate issue that is to be decided as a matter of federal substantive law. This was first made clear in this Court's decision in *Moses H. Cone, supra,* 460 U.S., at 24-25. In that case, this Court stated as follows:

> The basic issue presented in Mercury's federal suit was *the arbitrability of the dispute* between Mercury and the Hospital. Federal law in the terms of the Arbitration Act governs that issue in either state or federal court.
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> * * *
>
> The Arbitration Act establishes that, as a matter of federal law, any doubts *concerning the scope of arbitrable issues* should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.

(Emphasis added.) *See also Mitsubishi Motors Corp., supra,* 473 U.S., at 626 (the decision as to whether a particular dispute is within the scope of the parties' agreement to arbitrate is to be made according to the federal substantive law of arbitrability); *Volt Info. Sciences, supra,* 489 U.S., at 475-76 (although general state-law principles govern basic interpretation of the validity of an arbitration

agreement, determinations as to the scope of the arbitrable issues under the agreement must be resolved according to federal policy favoring arbitration).

The Ninth Circuit cases cited by Petitioners all derive from this Court's holding in *Moses H. Cone*. The line of cases begins with *Bayma v. Smith Barney, Harris, Upham & Co., Inc.*, 784 F.2d 1023 (9th Cir. 1986), a case which preceded this Court's instruction in *Perry*, that it is state law principles that govern underlying issues of validity, by at least a year. 482 U.S., at 492 n.9. The issue presented in the *Bayma* case was whether an employment dispute was arbitrable under the terms of an arbitration agreement in an employee contract. The district court had found the provision revocable under state law. *Id.*, at 1023; *accord Hope v. Superior Court*, 122 Cal.App.3d 147, 175 Cal.Rptr. 851 (Cal.App. 1 Dist.), *cert. denied*, 456 U.S. 910 (1981). The Ninth Circuit, however, defined the issue as one of arbitrability, i.e., whether the employment dispute was arbitrable or whether it was exempt from the requirements of the arbitration provision. *Id.*, at 1024. Relying on this Court's holding in *Moses H. Cone*, the Ninth Circuit held that federal law applied on the issue of arbitrability and did not permit the state to carve out exceptions. The court concluded that, "[i]f the contract is one 'involving commerce,' then the question of arbitrability is controlled by federal law and not by state law." *Id.*, at 1025.

In *Cohen v. Wedbush, Noble, Cooke, Inc.*, 841 F.2d 282 (9th Cir. 1988), decided less than a year after this Court's decision in *Perry v. Thomas*, sophisticated investors attempted to avoid arbitration of their disputes with a stock brokerage firm. Although the court generally stated

that "the availability and validity of defenses against arbitration are therefore to be governed by application of federal standards," (841 F.2d at 285, *citing Bayma*), the court again defined the issue as primarily one of arbitrability of the issues, rather than the underlying validity of the agreement. *See e.g., id.*, at 285 (" '[Q]uestions of *arbitrability* must be addressed with a healthy regard for the federal policy favoring arbitration' "), *citing Moses H. Cone*, 460 U.S., at 24; *id.*, at 286 ("state law adhesion contract principles may not be invoked to bar *arbitrability* of disputes under the Arbitration Act"), *citing Bayma*, 784 F.2d, at 1024 (emphasis added).[6]

The Ninth Circuit also acknowledged in the *Cohen* decision that general principles of contract law apply to a court's determination of the underlying validity of an

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[6] There is clearly a recognizable distinction between the application of state law adhesion principles to the underlying validity of an agreement, and the application of such principles to a determination of the arbitrability of a particular dispute. As the California Court of Appeal recognized in this case, and as this Court has previously instructed, while contracts of adhesion are fully enforceable, "courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds 'for the revocation of any contract.' 9 U.S.C. § 2." *Southland Corp. v. Keating*, *supra*, 465 U.S., at 16, n.11. In contrast, state law principles of adhesion are preempted by federal law when determining the scope of an admittedly valid arbitration agreement. Whereas state law would require that the scope of a contract provision be construed against the drafter, federal law requires that the scope of an arbitration agreement be broadly construed, such that "any doubts about the scope of arbitrable issues should be resolved in favor of arbitration." *Moses H. Cone Memorial Hosp.*, *supra*, 460 U.S., at 24.

arbitration provision. Like the Respondents in this case, the plaintiffs in *Cohen* also asserted that the arbitration provision at issue was unconscionable because the forum designated (the NYSE) was presumptively biased. The Ninth Circuit did not dismiss this contention as inappropriate under federal law. Rather, the court made a substantive determination that "because Congress has committed to the SEC the task for ensuring that the federal rights established by the Securities Acts are not compromised by inadequate arbitration procedures, we are bound by the commission's determination that the procedures at issue here are satisfactory." *Id.*, at 286. Similarly, in response to the plaintiffs' contention that their consent to the arbitration provision had been induced by fraud, the Ninth Circuit applied "traditional common law principles" and rejected the plaintiffs' claim of reliance. *Id.*, at 287.

Finally, in *Mago v. Shearson Lehman Hutton, Inc.*, 956 F.2d 932 (9th Cir. 1992), the primary issue was whether the plaintiff's Title VII claim was within the scope of arbitrable issues. Because the plaintiff also challenged the arbitration agreement as an unenforceable contract of adhesion, the Ninth Circuit again repeated its holding in *Bayma* and *Cohen* that "state law adhesion principles may not be invoked to bar arbitrability of disputes under the [Federal] Arbitration Act." *Id.*, at 956 F.2d, at 932 (citation omitted). The Ninth Circuit also acknowledged, however, this Court's instruction that " 'courts should remain attuned to well-supported claims that the agreement to arbitrate resulted from the sort of fraud or overwhelming economic power that would provide grounds for the revocation of any contract,' " *citing Gilmer v. Interstate/*

Johnson Lane Corp., supra, 111 S.Ct., at 1656, and remanded to the district court for a determination on the factual issue of adhesion. *Id.,* at 934-35.

Furthermore, in a case not cited by Petitioners, the Ninth Circuit explicitly recognized that is general state law principles that apply in determining the underlying validity of an arbitration clause. In *Teledyne, Inc. v. Kone Corporation,* 892 F.2d 1404 (9th Cir. 1990), a party to an arbitration clause sought to avoid arbitration by denying the existence of the contract as a whole. Citing *Prima Paint Corp., supra,* 388 U.S., at 402-04, the Ninth Circuit held that cases must be submitted to arbitration unless there is a challenge to the arbitration provision "which is *separate* and *distinct* from any challenge to the underlying contract." *Teledyne, Inc., supra,* 892 F.2d, at 1410. The court then noted that, under the Section 2 of the FAA, "general principles of law and equity" are relevant in determining whether there is an independent challenge to an arbitration clause, and that it is in this "narrow class of cases in which state law is relevant under the Federal Arbitration Act." *Id.,* at 1410-11.

Thus, like this Court, the Ninth Circuit has held that federal law applies when the issue presented is the *arbitrability* of a particular dispute governed by the FAA. When the issue presented is the underlying *validity* of an arbitration provision, however, as was the issue in this case, the Ninth Circuit has acknowledged that it is general principles of state contract law that govern such a determination. Accordingly, there is no conflict between the decisions of the Ninth Circuit and the opinion of the California Court of Appeal in this case.

Moreover, once this important distinction is made between the issues of underlying validity and arbitrability, the supposed conflict between the California Court of Appeal decision in this case and the decisions of other federal courts cited by Petitioners similarly evaporates. For example, in *Neal v. Hardee's Food Systems, Inc.*, 918 F.2d 34 (5th Cir. 1990), *reh'g. denied*, the court defined the issue presented as "whether the broad arbitration clause contained in the License Agreements entered into between the parties applies to the claims contained in Neal's petition pending in the district court." 918 F.2d, at 36. In a footnote, the court noted that "federal law applicable to this decision simply comprises generally acceptable principles of contract law. . . . We look to state law to shape these general principles." *Id.*, at 37-38, n.5 (citations omitted). *See also Eassa Properties v. Shearson Lehman Brothers*, 851 F.2d 1301, 1304 n.7 (11th Cir. 1988) ("While federal law may govern the interpretation and enforcement of a valid arbitration agreement, state law governs the question of whether such an agreement exists in the first instance."); *Cost Brothers, Inc. v. Travelers Indemnity Company*, 760 F.2d 58, 60 (3d Cir. 1985) (while federal law governs the construction of an arbitration agreement, the actual question presented was one of surety law to which state surety law applied); *Flink v. Carlson*, 856 F.2d 44, 46, n.2 (8th Cir. 1988) (the question of what persons are bound by an arbitration agreement subject to the FAA is a question of federal law, "but since that question involves the 'general law' of contracts and agency, federal courts look to state law in shaping federal law").

The illusion of conflict is further dissipated once proper distinctions are made between cases decided prior to this Court's 1987 decision in *Perry v. Thomas*, and those decided subsequent to the decision. *See e.g.*, Petition, at footnote 5, in which the Petitioners compare *Eassa Properties, supra*, 851 F.2d, at 1304, a case decided in 1988, with *In re Hart Ski Mfg. Co.*, 711 F.2d 845 (8th Cir. 1983), a one-page opinion decided in 1983, four years prior to *Perry*. Similarly, on page 16 of the Petition, the Petitioners criticize this Court's holding in *Perry* as inconsistent with *Coenen v. R.W. Pressprich & Co.*, 453 F.2d 1209, 1211 (2d Cir. 1972), *cert. denied*, 406 U.S. 949 (1972), a decision of the Second Circuit Court of Appeals that preceded this Court's decision in *Perry* by at least fifteen years.

The post-*Perry* decisions of the First and Fourth Circuits in *Securities Industry Ass'n v. Connolly*, 883 F.2d 1114 (1st Cir. 1989), *cert. denied* 495 U.S. 956 (1990), and *Saturn Distribution Corp. v. Williams*, 905 F.2d 719 (4th Cir.), *cert. denied* 498 U.S. 983 (1990), demonstrate that the Circuit Courts of Appeal have no difficulty in applying the *Perry* instruction. In those cases, the courts acknowledged the applicability of general principles of state contract law in determining the underlying validity of an arbitration provision, but invalidated state laws that imposed special restrictions on the formation of arbitration agreements. The decisions were thus fully consistent with both this Court's holding in *Perry* and with the decisions of other Circuit Courts of Appeal.

Thus, while federal courts have not always exercised a great deal of precision in describing when federal law applies to arbitration agreements governed by the FAA and when general principles of state contract law are

applicable, there is no actual conflict on this issue among the lower courts. This Court's holding in *Perry v. Thomas* settled the issue and need not be revisited.

II. EVEN IF THIS COURT INTENDED TO REVISIT THE ISSUE DECIDED IN *PERRY V. THOMAS*, THE COURT SHOULD NOT ISSUE A WRIT IN THIS CASE BECAUSE THE GENERAL PRINCIPLES OF STATE CONTRACT LAW APPLIED BY THE CALIFORNIA COURT OF APPEAL ARE NOT IN CONFLICT WITH FEDERAL LAW.

Even if this Court were inclined to revisit the issue it resolved in *Perry v. Thomas*, this case is not the proper vehicle for doing so. The doctrine of unconscionability applied by the California Court of Appeal in this case to invalidate the ITT arbitration provision is not unique to California law, is not uniquely applicable to arbitration agreements, and does not conflict in any way with federal common law. Thus, if this court intended to instruct state or federal courts further on the limitations of applying unique state law principles to arbitration agreements governed by the FAA, review in this case would not accomplish that purpose. Moreover, if the Court desired to reexamine the application of state law principles of contract interpretation to arbitration agreements governed by the FAA, the issue should be addressed in a case in which there is a clear conflict between the applicable state and federal law. No such conflict exists in this case.

The doctrine of unconscionability applied by the California Court of Appeal in this case, as set forth in *A & M. Produce Co. v. FMC Corp.*, *supra*, 135 Cal.App.3d 473, is derived directly from the Uniform Commercial Code and

federal common law. Indeed, in describing the doctrine, the *A & M Produce* court cited and relied heavily upon the well-known case *Williams v. Walker-Thomas Furniture Company*, 350 F.2d 445 (D.C. Cir. 1965), in which the court described the doctrine of unconscionability, as a matter of federal common law, in terms almost identical to those applied by the California Court of Appeal in this case.

> Unconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.

Williams, 350 F.2d, at 449.

The *A & M Produce* case also notes that California's doctrine of unconscionability is derived from section 2-302 of the Uniform Commercial Code, which has long been applied by both federal and state courts to deny enforcement of unconscionable contract provisions. *See e.g.*, § 2-302 Uniform Commercial Code (West 1989); *Williams v. Walker-Thomas Furniture Company, supra*, 350 F.2d, at 449; *Industralease Automated & Scientific Eg. Corp., Etc.*, 58 A.D.2d 482, 396 N.Y.S.2d 427 (1977); *Geldermann & Co. v. Lane Processing, Inc.*, 527 F.2d 571, 575 (8th Cir. 1975). In *Geldermann & Co.*, the court explained that the doctrine of unconscionability as currently codified in U.C.C. § 2-302 originated in English common law, and was first approved by the Supreme Court in 1889 in *Hume v. United States*, 132 U.S. 406, 411 (1889). In describing the doctrine, the court in *Geldermann & Co.* emphasized the same considerations that formed the basis of the California's court's analysis in *A & M Produce Co.* – whether there was a gross inequity of bargaining power between the parties,

whether the aggrieved party was aware of and comprehended the provision in question, and whether the provision at issue was a commercially reasonable allocation of risks. 527 F.2d, at 575-76; *see also* 1 Arthur Corbin, *Corbin on Contracts*, § 128 (1992 Supp.); *Restatement Second Contracts* 2d, § 208, (1979).[7] Thus, the doctrine of unconscionability applied by the California Court of Appeal in this case is one of the most long-standing and generally-applicable principles of both federal and state contract law that "exist[s] at law or equity for the revocation of any contract." 9 U.S.C. § 2. Accordingly, regardless of whether the California Court of Appeal had applied state or federal common law, based on the evidence in the record, the result would have been the same.

This Court has always been mindful of the possibility of unfairness in the arbitration context, and has never held that arbitration provisions are necessarily exempt from general contractual principles of adhesion, oppression and unconscionability. Rather, this Court

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[7] In addition, it is clear that the analysis for determining unconscionability applied by the Court of Appeal was not uniquely applicable to arbitration provisions, but rather was applicable to contracts generally. The same analysis has been applied by courts in California to a variety of contractual provisions, including a provision requiring an unconscionable interest rate (*Carboni v. Arrospide*, 2 Cal.App.4th 76, 2 Cal.Rptr. 2d 845 (Cal.App. 1 Dist. 1992) *rev. denied*; a provision establishing an NSF bank charge (*Perdue v. Crocker National Bank*, 38 Cal.3d 913, 216 Cal.Rptr. 345, 702 P.2d 503, *appeal dismissed*, 475 U.S. 1001 (1985)); and a provision imposing a termination fee for an IRA account (*Dean Witter Reynolds v. Superior Court*, 211 Cal.App.3d 758, 259 Cal.Rptr. 789 (Cal.App. 1 Dist. 1989), *rev. denied.*)

has cautioned that allegations of oppression and unconscionability remain relevant, (*see Mitsubishi Motors Corp., supra,* 473 U.S., at 627; *Gilmer, supra,* 111 S.Ct., at 1656), and that determinations on these issues must be made in individual cases based on evidence in the record. *See e.g., Perry v. Thomas, supra,* 482 U.S., at 492 n.9 (claim of unconscionability to be considered on remand); *Gilmer, supra,* at 111 S.Ct., at 1656; *Rodriguez De Quijas v. Shearson/American Exp., Inc.,* 490 U.S. 477, 484 (1989).

The cases cited by Petitioners in which federal courts have enforced arbitration agreements alleged to be adhesion contracts are distinguishable in two important aspects – the relative sophistication of the adhering party, and the lack of any evidence supporting the claim of adhesion and unconscionability. *See e.g., Gilmer, supra,* 111 S.Ct., at 1656, (the record showed that Gilmer was "an experienced businessman" and did not contain any evidence of coercion in the signing of the arbitration clause); *Rodriguez De Quijas v. Shearson/American Exp., Inc., supra,* 490 U.S., at 484 (the record showed that plaintiffs were large-scale securities investors and contained no evidence that the contract was one of adhesion); *Passage v. Prudential-Bache Securities, Inc.,* 727 P.2d 1298, 1302 (Mont. 1986), *cert. denied,* 480 U.S. 905 (1987) (although brokerage agreement may have been one of adhesion, there was no evidence presented that it was oppressive or unconscionable); *Webb v. Rowland & Co., Inc.,* 800 F.2d 803, 807 (8th Cir. 1986) (contract of adhesion is only invalid if it is also unconscionable).

The evidentiary record in this case is markedly different. Respondents in this case did not merely assert that the arbitration provision was unenforceable because it

was a contract of adhesion. Rather, Respondents established through evidence in the record the specific manner in which the provision was procedurally and substantively unconscionable. This evidence established not only that the arbitration provision was a contract of adhesion, but also that Respondents were relatively unsophisticated, lower-income consumer borrowers who did not reasonably anticipate that an arbitration provision requiring arbitration in Minnesota would be contained in the loan documents they signed in California. More importantly, the evidence also established that, in operation and effect, the provision was substantively unfair and oppressive for the consumer parties. As the Court of Appeal found, by designating a distant, inaccessible, and prohibitively expensive forum, the arbitration provision appeared to have been designed to, and effectively did, deny California consumers any meaningful opportunity to present their claims or defenses. (Petition Appendix, 8a-9a.) Regardless of whether the Court of Appeal applied federal or state common law, the unique facts of this case clearly established grounds for denying enforcement of the arbitration provision.

III. THERE IS NO JUSTIFICATION FOR THIS COURT'S REVIEW BECAUSE THE CALIFORNIA COURT OF APPEAL DECISION IS UNIQUE TO THE PARTICULAR FACTS OF THIS CASE, DOES NOT CREATE PRECEDENT FOR THE STATE OF CALIFORNIA, AND DOES NOT EVIDENCE ANY STATEWIDE HOSTILITY TOWARD ENFORCEMENT OF ARBITRATION AGREEMENTS.

Despite Petitioners' attempt to portray this case as a frontal assault on arbitration agreements by California courts, the Court of Appeal opinion is clearly limited to the unique facts of this case and is of little or no precedential significance. It is not an opinion of the California Supreme Court, and has no binding precedential effect beyond the District in which it was decided. Nothing in the opinion below criticizes or conflicts in any way with precedent of other California Courts of Appeal or of the California Supreme Court.

Furthermore, the opinion neither stated nor implied any hostility whatsoever to arbitration agreements or to the arbitral process. Indeed, the opinion is utterly devoid of any broad statements about the arbitration process in general. Nor does the opinion assert any state law preemption of the provisions of the FAA. Rather, the Court of Appeal simply applied basic contract law to determine, based on the evidence in the record, the validity of a contractual arbitration provision. Because the evidence showed that, in this particular case, "the procedure seem[ed] designed to discourage borrowers from responding at all" and came "perilously close" to denying consumers a fair opportunity to present their claims,

the court found the provision to be invalid. (Petition Appendix, 8a-9a.) Given that most arbitration agreements designate a widely-accepted or well-known forum, equally accessible to both parties, it is highly unlikely that the obvious unfairness evident in this case would re-occur in any other case.

Petitioners' contention that "hostility to arbitration . . . still flourishes in the California courts" is clearly false.[8] (Petitioner, at 13-14) As the Court will note, Petitioners fail to cite any California case whatsoever in support of this assertion, and indeed, there are none. In fact, it would be difficult to imagine a more resounding endorsement of both the concept and the process of arbitration than is demonstrated by the California Supreme Court's recent opinion in *Moncharsh v. Heily & Blase*, 3 Cal.4th 1, 10 Cal.Rptr. 2d 183, 832, P.2d 899, *reh'g. denied*, (1992). In that case, the Court addressed the issue of whether, and under what conditions, a trial court was allowed to review an arbitrator's decision. *Id.*, at 8. The Court emphasized both the state's " 'strong public policy in favor of arbitration as a speedy and relatively inexpensive means of dispute resolution,' " (3 Cal.4th, at 9, citations omitted), and the importance of enforcing the parties' expectations of finality. *Id.*, at 10. The Court concluded that, except in the limited exceptions created by statute, an award reached by an arbitrator is not subject to judicial review *even if errors of law or fact are apparent on*

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[8] The contention is also an abrupt reversal of the argument strenuously asserted by Petitioners in each of the lower courts in this case that the California case law demonstrates a clear policy favoring the enforcement of arbitration agreements.

the face of the award, and even if those errors cause substantial injustice to the parties. Id., at 33.

Through *Moncharsh* and other decisions, the California Supreme Court and California Courts of Appeal have made clear the state's own strong judicial policy favoring arbitration, as well as the courts' respect for and deference to the arbitral process. *See e.g., Ericksen, Arbuthnot, Etc. v. 100 Oak Street*, 35 Cal.3d 312, 322-323, 197 Cal.Rptr. 581, 673 P.2d 251 (1983) (California has a strong public policy in favor or arbitration, and doubts concerning the scope of arbitrable issues are to be resolved in favor of arbitration); *Rowland v. Paine Webber, Inc.*, 4 Cal. App.4th 279, 284, 6 Cal.Rptr. 2d 20, (Cal.App.2 Dist. 1992) ("California has a strong public policy in favor of arbitration as a speedy and relatively inexpensive means of dispute resolution"; arbitration agreement would be enforced even though plaintiff claimed he was unaware of the provision and that his consent was obtained by fraud); *Izzy v. Mesquite Country Club*, 186 Cal.App.3d 1309, 1318-19, 231 Cal.Rptr. 315, (Cal.App. 4 Dist. 1986) (arbitration provision was not unconscionable and was fully enforceable even though plaintiff failed to read the provision before signing contract); *Bolanos v. Khalatian*, 231 Cal.App.3d 1586, 283 Cal.Rptr. 209 (Cal.App. 2 Dist. 1991) (arbitration agreement related to medical services would be enforced even though the patient had only limited reading ability and did not remember signing agreement; agreement would also be enforced against husband and child even though neither was a signatory to the agreement).

Thus, California courts have consistently and repeatedly enforced valid arbitration agreements. The opinion

of the Court of Appeal below denying enforcement of the ITT arbitration provision was clearly limited to the unique facts of this case and compelled by the evidence in the record. The decision does not conflict in any way with the FAA or with federal common law, and presents no basis whatsoever for this Court's review.

CONCLUSION

For all the foregoing reasons, this Court should deny the petition for writ of certiorari.

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Respectfully submitted,

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